



FHA's 203(k) Loan Program

How Can Banks Use the 203(k) Loan Program?

The Federal Housing Administration (FHA) 203(k) Home Rehabilitation Mortgage Insurance Program offers a loan product that combines a property acquisition and rehabilitation loan into one instrument, which is backed by the full faith and credit of the U.S. government. With millions of properties entering foreclosure that need repair, this product can help fill a growing market niche as well as assist in the revitalization of neighborhoods affected by the current foreclosure crisis.

What Are the Benefits to Banks That Offer 203(k) Loans?

There are several important benefits for those financial institutions that offer the 203(k) loans. The program can expand a bank's customer base because these loans provide mortgage credit to borrowers who are unable to make a substantial down payment. 203(k) loans only require a 3.5 percent down payment. These loans produce origination and servicing fee income. Moreover, 203(k) loans can be placed in Ginnie Mae securities, providing liquidity and secondary market fee income. 203(k) loans produce income while mitigating risk, since loans are 100 percent insured at closing. These loans may also assist banks in receiving positive consideration under the Community Reinvestment Act lending test and may enhance bank and nonprofit partnerships since nonprofits are eligible to receive 203(k) loans.

How Does the 203(k) Loan Program Work?

Banks originate 203(k) loans, and the FHA insures these privately issued mortgages. There are two types of 203(k) loans.

- Standard (k) loans are for complex projects that require substantial structural renovation, including major roof repairs, added rooms, or replacement of plumbing. The standard (k) loan has no maximum for the repairs.
- Streamlined (k) loans are for simple and cosmetic repairs, such as new flooring, minor kitchen remodeling, or gutter repair. The streamlined (k) loan has a maximum repair amount of \$35,000.

For both types of 203(k) loans, the gross loan amount must not exceed FHA loan limits. FHA loan limits vary by geography and range, for a single-family unit, from \$271,050 to \$729,750 in high-cost areas. Eligible borrowers include individuals, nonprofits, and government development agencies. Properties must be one- to four-family dwellings that have been completed for at least one year. 203(k) loans can be used to refinance an existing loan. Pricing for 203(k) loans is determined by market conditions and is typically one percent higher than traditional FHA loans. 203(k) loans can be offered for 15- or 30-year terms, and the interest rate can be variable or fixed.

How Do Lenders Participate in the 203(k) Loan Program?

Banks and supervised lenders must seek approval by the FHA to offer 203(k) loans. Loans are approved through the FHA's automated underwriting system, TOTAL Mortgage Score, or approved by FHA's Direct Endorsement underwriters. If default occurs, lenders must file a mortgage insurance claim with the FHA.

Example of Standard FHA 203(k) Loan

Sources of Funds

203(K) Loan	\$ 241,250
3.5 Percent Down Payment	8,750
Total Sources of Funds	250,000

Uses of Funds

Purchase Price	\$ 150,000
Rehabilitation Cost	92,500
Estimated Fees	7,500
Total Uses of Funds	\$ 250,000

For More Information

- 203(k) Loan Program overview
www.hud.gov/offices/hsg/sfh/203k/203kmenu.cfm
- Q&As on FHA 203(k) Loan Program
www.hud.gov/offices/hsg/sfh/203k/faqs203k.cfm
- 203(k) handbook
www.hud.gov/offices/adm/hudclips/handbooks/hsg/4240.4/index.cfm
- FHA loan limits
<https://entp.hud.gov/idapp/html/hicostlook.cfm>
- OCC *Insights* report on the 203(k) Loan Program
http://www.occ.gov/cdd/203k_Loan%20Program_Insights_Jul09.pdf
- OCC's District Community Affairs Officers contact information
www.occ.treas.gov/cdd/commfoc.htm

What Are the Risks to Banks?

There are several operational areas where banks need to have sufficient management and underwriting capacity to offer 203(k) loans. Banks should consider their capacity to monitor real estate construction activities and administrative oversight to manage rehabilitation escrow accounts. Lenders must conduct proper borrower screening to ensure the borrower is not a for-profit investor. Banks should perform necessary due diligence when entering into third-party relationships to originate 203(k) loans.